

SURFACE TRANSPORTATION BOARD

DECISION

STB Docket No. 42071

OTTER TAIL POWER COMPANY

v.

BNSF RAILWAY COMPANY¹

Decided: May 26, 2006

By complaint filed on January 2, 2002, Otter Tail Power Company (Otter Tail) challenged the reasonableness of the rates charged by BNSF Railway Company (BNSF) for movements of coal from mine origins in the Powder River Basin (PRB) of Wyoming to the Big Stone Generating Station (Big Stone) located near Milbank, SD. In our prior decisions addressing the merits of this case,² we found that Otter Tail had failed to demonstrate that the rates charged by BNSF were unreasonable under the agency's stand-alone cost (SAC) methodology. Accordingly, Otter Tail's complaint against BNSF was dismissed.

Otter Tail has filed a petition for judicial review with the United States Court of Appeals for the Eighth Circuit.³ In accordance with Federal Rules of Appellate Procedure, Otter Tail has identified three issues it may raise before the court: our application of the cross-subsidy test, our exclusion of evidence regarding debt refinancing, and our decision to use BNSF's evidence on the unit cost of SD70 and C44-9 locomotives.

SAC cases involve the resolution of myriad technical, fact-based issues regarding the construction and operation of a railroad, a multitude of complex computer calculations, and the review of thousands of pages of evidence. While we make every effort to ensure that our final decisions accurately reflect all of the relevant evidence, errors can occur. We stand ready to correct any errors brought to our attention. The preferred procedure for bringing such errors to our attention is to seek administrative reconsideration prior to seeking judicial review. In this case, although Otter Tail filed a petition (jointly with BNSF) asking us to correct technical errors, it did not file a petition for reconsideration of any other issue.

¹ Effective January 20, 2005, The Burlington Northern and Santa Fe Railway Company changed its name to BNSF Railway Company.

² Otter Tail Power Co. v. BNSF Ry., STB Docket No. 42071 (STB served Jan. 27, 2006), corrected, Otter Tail Power Co. v. BNSF Ry., STB Docket No. 42071 (STB served Mar. 28, 2006).

³ Otter Tail Power Co. v. STB, No. 06-1962 (8th Cir. filed Apr. 10, 2006).

Nevertheless, it has come to our attention that, based on the record that was before us, it was in fact an error for us to accept BNSF's locomotive unit costs. Therefore, to avoid unnecessary delays in this long-running case and to facilitate the court's review, we will correct that error now. This action will not interfere with the court's jurisdiction. American Farm Lines v. Black Ball Freight Serv., 397 U.S. 532, 541 (1970). Rather, federal courts have stated that such self-corrections by the agency, even if done after a petition for judicial review is filed, are "helpful to the court." See McCarty Farms, Inc. v. STB, 158 F.3d 1294, 1301 n.1 (D.C. Cir. 1998). Agency self-correction is more expeditious and efficient than judicial review, Commonwealth of Pennsylvania v. ICC, 590 F.2d 1187, 1194 (D.C. Cir. 1978), and eases the burden on the reviewing court.

Accordingly, we are reopening this proceeding on our own initiative, pursuant to 49 U.S.C. 722(c)(1), to correct our prior decision to use BNSF's unit costs for locomotives. As shown below, accepting Otter Tail's evidence on the unit cost of locomotives has no material impact on the outcome of the case.

DISCUSSION AND ANALYSIS

Otter Tail based its cost evidence for the stand-alone railroad (SARR) to lease road locomotives (consisting of SD70 locomotives and C44-9 locomotives) on a BNSF lease. In computing the cost, Otter Tail took the two lease payments from the first year of the lease — a total of \$93,511 for SD70 locomotives and \$73,809 for C44-9 locomotives — and used those totals as the annual lease cost. On reply, BNSF argued that Otter Tail's methodology was flawed because the lease payments in the first year of the lease were much lower than payments in the later years of the lease. BNSF argued that "the correct annual lease payments should be based on the normalized annual payments included in the agreement."⁴ Accordingly, BNSF used a simple average of all of the lease payments to calculate the proposed leasing costs for each type of locomotive.

In its rebuttal, Otter Tail pointed out that BNSF's approach would result in a double-count of inflation,⁵ because the discounted cash flow (DCF) procedure would take the average unit cost developed by BNSF and apply an inflation cost adjustment factor, known as the RCAF-U. Otter Tail argued that this results in an overstatement of locomotive costs by 30%. Otter Tail noted that the approach it used was consistent with prior Board precedent.

In our January 2006 Decision (at C-3), we accepted BNSF's lease cost "as the best evidence of record, as lease rates for the first year appear significantly lower than the average over the full rental period." We failed, however, to address Otter Tail's rebuttal evidence. Having again reviewed the arguments and evidence, we agree that BNSF's approach double-counted inflation and that Otter Tail's evidence therefore should have been used as the best evidence of record.

⁴ BNSF Reply Narr. III-D-2.

⁵ Otter Tail Reb. E-WP. "Analysis of BNSF Loco Lease Calcs.xls".

Table 1 shows the extent of the double-count. We use the DCF composite cost of capital for 2002 of 10.21% to calculate the net present value (NPV) of the payments. As shown, the NPV of the actual lease payments for an SD70 locomotive is \$1.1 million. Using Otter Tail's approach, the NPV of payments the SARR would need to pay would be \$1.0 million, while under BNSF's approach, the SARR would need to pay \$1.5 million, or almost 50% more than the actual lease payments. **Table 2** shows comparable results for C-44 locomotives.

Table 1
SD70 Locomotive Lease Payments

Year	Actual Payment*	RCAF-U**	BNSF***	Otter Tail****
2002	\$93,511	1.002	\$133,292	\$93,680
2003	89,294	1.046	139,128	97,781
2004	90,731	1.090	145,066	101,955
2005	121,124	1.180	157,040	110,370
2006	121,124	1.218	161,990	113,850
2007	133,381	1.247	165,849	116,561
2008	132,139	1.276	169,807	119,343
2009	129,968	1.306	173,799	122,149
2010	135,477	1.338	178,023	125,118
2011	121,732	1.370	182,281	128,110
2012	353,509	1.403	186,638	131,173
2013	148,041	1.438	191,262	134,422
2014	148,041	1.474	196,052	137,788
2015	148,041	1.510	200,908	141,202
2016	148,041	1.548	205,931	144,732
2017	148,041	1.587	211,087	148,355
2018	148,039	1.626	216,342	152,049
2019	148,039	1.667	221,764	155,859
2020	148,039	1.709	227,319	159,764
2021	148,039	1.751	233,007	163,761
2022	57,568	1.795	238,824	167,849
2023	15,218	1.840	244,794	172,046
NPV	\$1,107,103		\$1,483,478	\$1,042,613

* Source: Otter Tail Reb. E-WP "Analysis of BNSF Loco Lease Calcs.xls"

** Source: STB DCF; four quarter averages with base (first quarter, 2002) set to 1.000

*** Derived by indexing BNSF base-year cost of \$113,052 by RCAF-U.

**** Derived by indexing Otter Tail base-year cost of \$93,511 by RCAF-U.

Table 2
C44-9 Locomotive Lease Payments

Year	Actual Payment*	RCAF-U**	BNSF***	Otter Tail****
2002	\$73,809	1.002	\$110,166	\$73,943
2003	70,481	1.046	\$114,989	77,180
2004	71,239	1.090	\$119,897	80,474
2005	95,437	1.180	\$129,793	87,117
2006	95,437	1.218	\$133,885	89,863
2007	105,722	1.247	\$137,074	92,003
2008	104,320	1.276	\$140,346	94,199
2009	101,756	1.306	\$143,645	96,413
2010	108,383	1.338	\$147,136	98,757
2011	96,104	1.370	\$150,655	101,119
2012	276,549	1.403	\$154,256	103,536
2013	116,646	1.438	\$158,078	106,101
2014	116,646	1.474	\$162,037	108,758
2015	116,646	1.510	\$166,050	111,452
2016	116,646	1.548	\$170,202	114,238
2017	116,646	1.587	\$174,463	117,098
2018	116,646	1.626	\$178,807	120,014
2019	116,646	1.667	\$183,288	123,022
2020	116,646	1.709	\$187,879	126,103
2021	116,646	1.751	\$192,580	129,259
2022	106,339	1.795	\$197,388	132,485
2023	63,888	1.840	\$202,322	135,798
NPV	\$886,607		\$1,226,093	\$822,946

* Source: Otter Tail Reb. E-WP “Analysis of BNSF Loco Lease Calcs.xls”

** Source: STB DCF; four quarter averages with base (first quarter, 2002) set to 1.000

*** Derived by indexing BNSF base-year cost of \$109,967 by RCAF-U.

**** Derived by indexing Otter Tail base-year cost of \$73,809 by RCAF-U.

We do not endorse the methodology used by Otter Tail to derive the unit costs for locomotives, particularly where there are large balloon payments in the structure of actual lease payments. Using the first year’s lease payment risks overstating or understating the unit costs if the lease payments are back-loaded or front-loaded. However, as shown in **Tables 1 & 2**, that is not the case here, and we should have used Otter Tail’s evidence as the best evidence of record.

Using Otter Tail's evidence on the unit costs of these two types of locomotives has no material impact on our decision.⁶ **Table 3** demonstrates that, even after correcting this error, Otter Tail's presentation continues to rely on an internal cross-subsidy.

Table 3
Western Part DCF Analysis
(Revised SD70 and C44-9 Locomotive Lease Payments)

Year	Attributable Costs	Forecast Revenues	Difference	Present Value	Cumulative Difference
2002	\$438,198,438	\$406,470,450	(\$31,727,988)	(\$31,324,440)	(\$31,324,440)
2003	433,739,842	399,426,444	(34,313,398)	(30,624,151)	(61,948,591)
2004	465,683,177	432,309,780	(33,373,397)	(25,991,065)	(87,939,656)
2005	500,428,608	467,352,489	(33,076,119)	(23,368,410)	(111,308,066)
2006	514,723,421	475,870,042	(38,853,379)	(24,856,118)	(136,164,184)
2007	530,153,156	487,537,462	(42,615,694)	(24,686,752)	(160,850,935)
2008	541,455,678	487,529,323	(53,926,355)	(28,286,899)	(189,137,834)
2009	552,792,788	485,233,069	(67,559,719)	(32,089,430)	(221,227,264)
2010	568,591,265	496,126,087	(72,465,178)	(31,166,886)	(252,394,151)
2011	583,888,947	505,196,500	(78,692,447)	(30,646,931)	(283,041,082)
2012	599,122,403	514,068,950	(85,053,453)	(29,994,096)	(313,035,178)
2013	614,949,883	523,012,861	(91,937,022)	(29,357,844)	(342,393,021)
2014	631,219,492	531,849,406	(99,370,086)	(28,732,888)	(371,125,909)
2015	647,984,926	541,144,177	(106,840,749)	(27,973,733)	(399,099,642)
2016	665,060,574	549,921,768	(115,138,806)	(27,297,640)	(426,397,282)
2017	682,656,557	559,067,384	(123,589,173)	(26,532,227)	(452,929,509)
2018	700,942,927	569,016,907	(131,926,020)	(25,645,645)	(478,575,154)
2019	719,999,766	580,430,658	(139,569,108)	(24,567,579)	(503,142,732)
2020	739,077,067	591,613,698	(147,463,369)	(23,504,288)	(526,647,020)
2021	758,920,348	604,145,211	(154,775,137)	(22,338,501)	(548,985,521)

CONCLUSION

We modify our earlier decisions to the extent discussed in this decision. Because this modification does not lead to a different result, we reaffirm our prior determination that Otter Tail failed to demonstrate that the challenged rates are unreasonable.

This decision will not significantly affect the quality of the human environment or the conservation of energy resources.

⁶ We also note that, even if we had used Otter Tail's evidence on the cost of debt (which we instead properly struck as improper rebuttal evidence), that would have had no impact on the outcome of the case. See Appendix A (showing the impact on the case of using Otter Tail's evidence on both locomotive unit costs and the cost of debt).

It is ordered:

1. Our prior decisions in this case are modified as discussed in this decision.
2. This decision is effective on May 26, 2006.

By the Board, Chairman Buttrey and Vice Chairman Mulvey.

Vernon A. Williams
Secretary

APPENDIX A

**Western Part DCF Analysis
(Revised SD70 and C44-9 Locomotive Lease Payments
and Otter Tail's Proposed Cost of Debt)**

Year	Attributable Costs	Forecast Revenues	Difference	Present Value	Cumulative Difference
2002	\$417,697,727	\$406,470,450	(\$11,227,277)	(\$11,060,974)	(\$11,060,974)
2003	412,896,020	399,426,444	(13,469,576)	(12,093,690)	(23,154,664)
2004	443,707,906	432,309,780	(11,398,126)	(9,092,663)	(32,247,327)
2005	477,704,808	467,352,489	(10,352,319)	(7,564,334)	(39,811,661)
2006	491,465,473	475,870,042	(15,595,431)	(10,418,303)	(50,229,964)
2007	506,336,841	487,537,462	(18,799,379)	(11,481,792)	(61,711,756)
2008	517,068,775	487,529,323	(29,539,452)	(16,494,349)	(78,206,105)
2009	527,795,134	485,233,069	(42,562,065)	(21,728,113)	(99,934,218)
2010	542,930,426	496,126,087	(46,804,339)	(21,844,998)	(121,779,216)
2011	557,533,438	505,196,500	(52,336,938)	(22,332,677)	(144,111,893)
2012	572,051,934	514,068,950	(57,982,984)	(22,620,365)	(166,732,258)
2013	587,143,535	523,012,861	(64,130,674)	(22,873,437)	(189,605,695)
2014	602,655,701	531,849,406	(70,806,295)	(23,088,944)	(212,694,639)
2015	618,641,459	541,144,177	(77,497,282)	(23,103,897)	(235,798,536)
2016	634,914,509	549,921,768	(84,992,741)	(23,165,794)	(258,964,330)
2017	651,684,259	559,067,384	(92,616,875)	(23,079,269)	(282,043,599)
2018	669,120,028	569,016,907	(100,103,121)	(22,805,842)	(304,849,441)
2019	687,301,137	580,430,658	(106,870,479)	(22,259,881)	(327,109,322)
2020	705,476,797	591,613,698	(113,863,099)	(21,682,764)	(348,792,086)
2021	724,391,715	604,145,211	(120,246,504)	(20,934,890)	(369,726,977)